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Pension Fund Activism: The Double-Edged Sword

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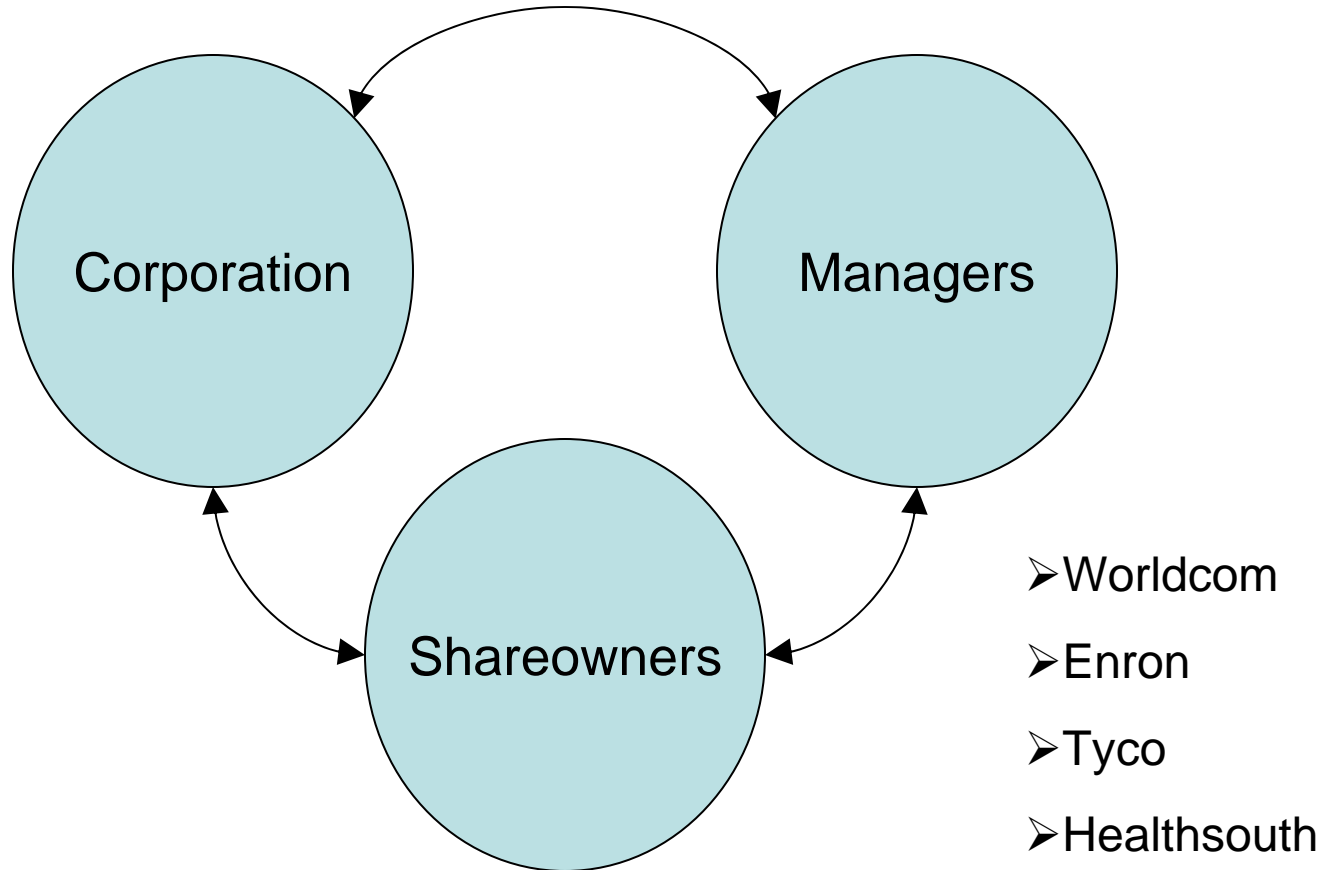
Professor of Finance

Graduate School of Management

UC Davis

First Agency Cost

Corporate Managers v. Shareholders

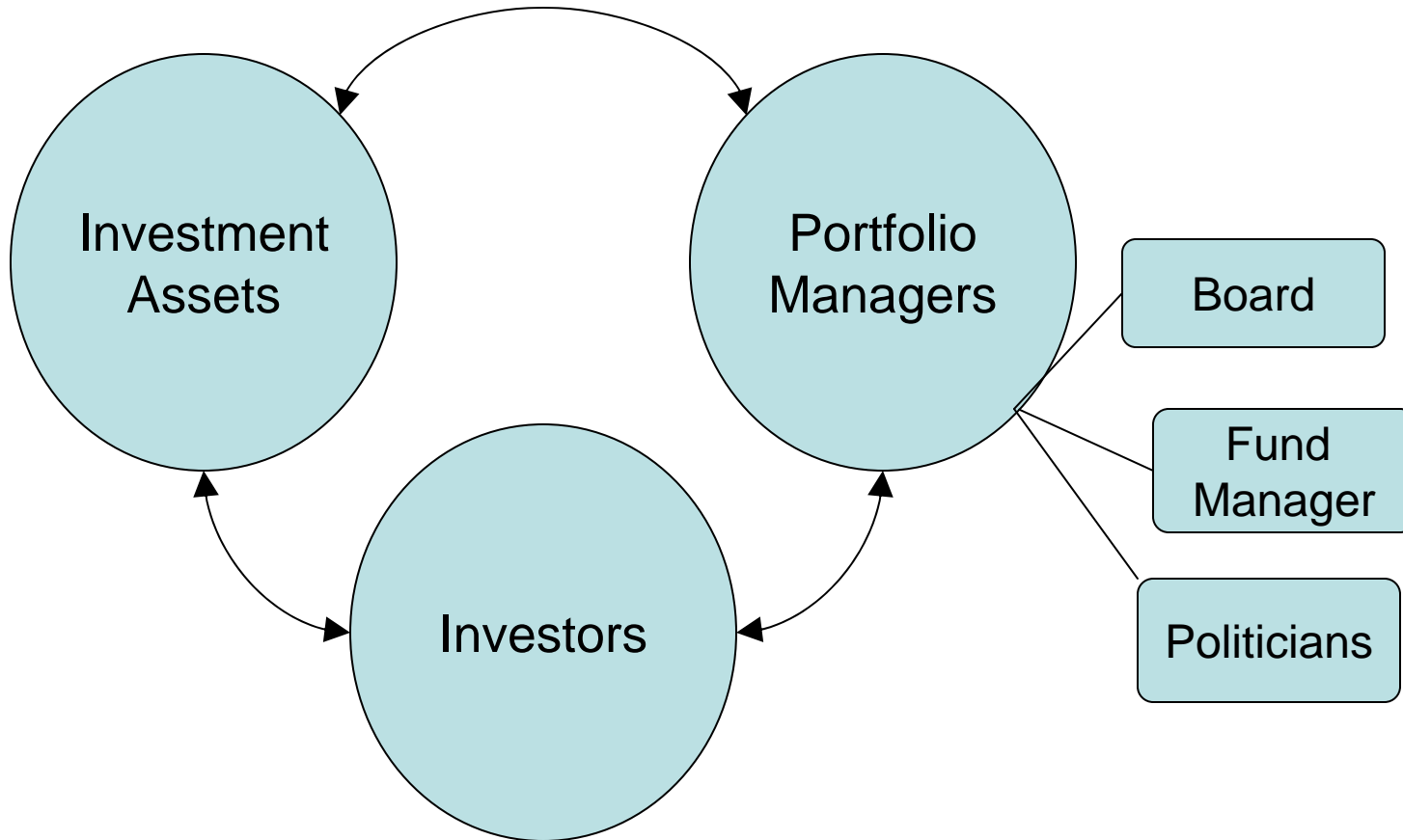


Controlling Managers

Reducing Agency Costs

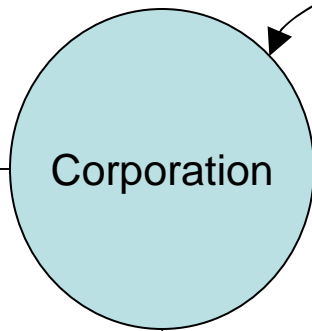
- Good Governance
 - Strong Shareholder Rights
 - Diligent Boards
- Compensation Packages
- External Monitoring
 - Institutional Investors

Second Agency Cost Portfolio Managers v. Investors

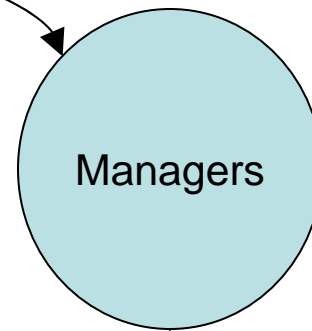




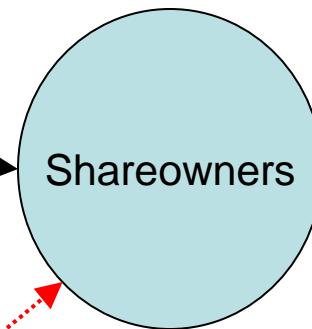
Externalities



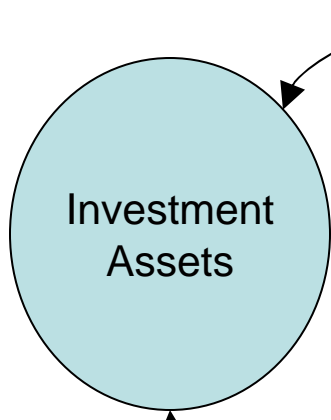
Corporation



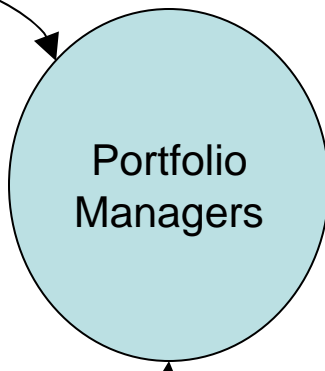
Managers



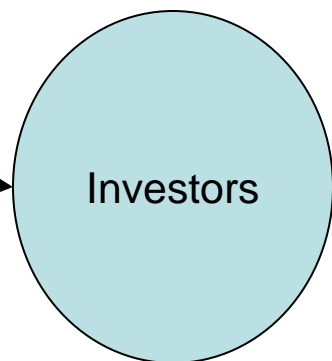
Shareowners



Investment
Assets



Portfolio
Managers



Investors

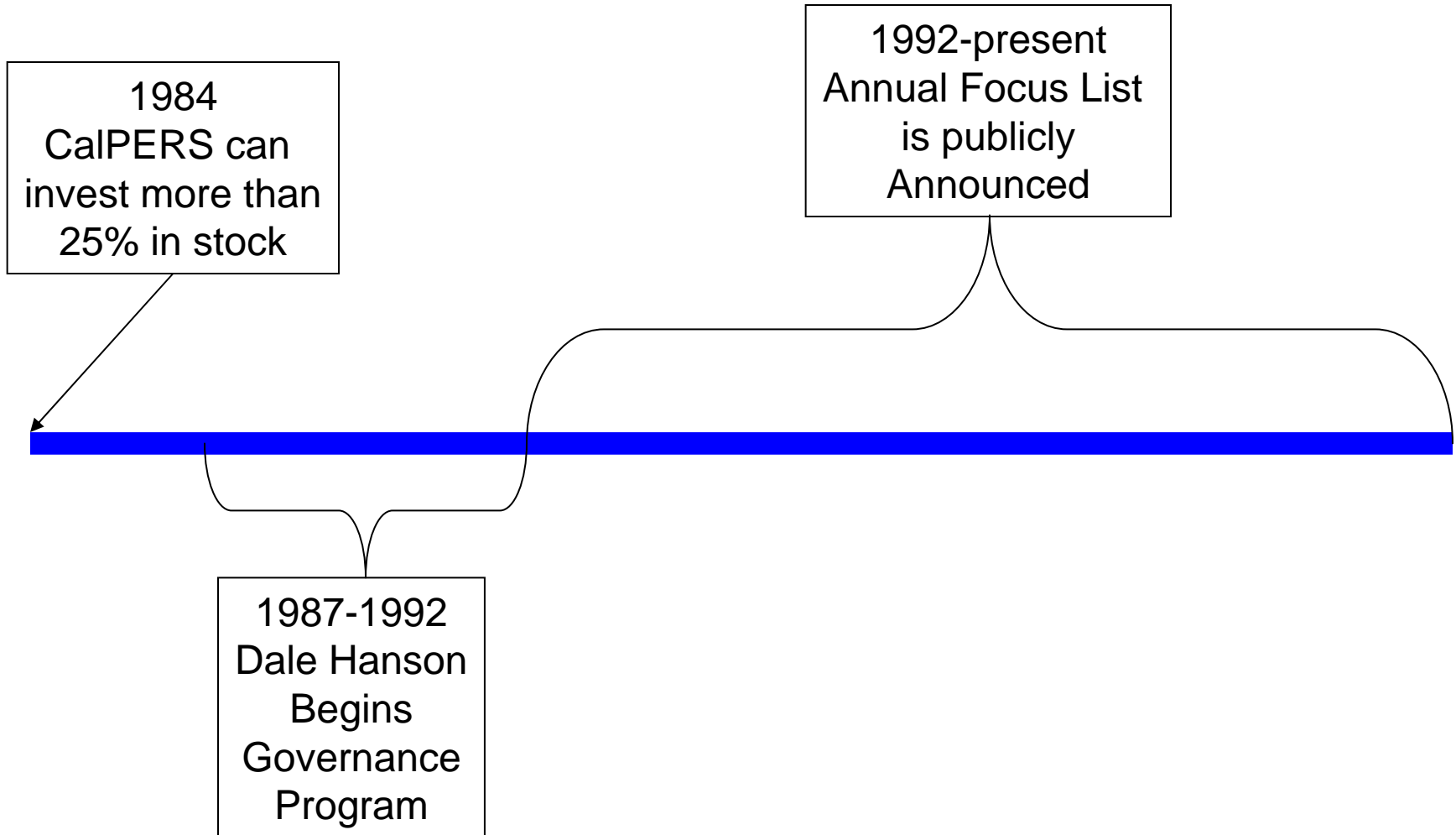


Self-Serving
Autocrat



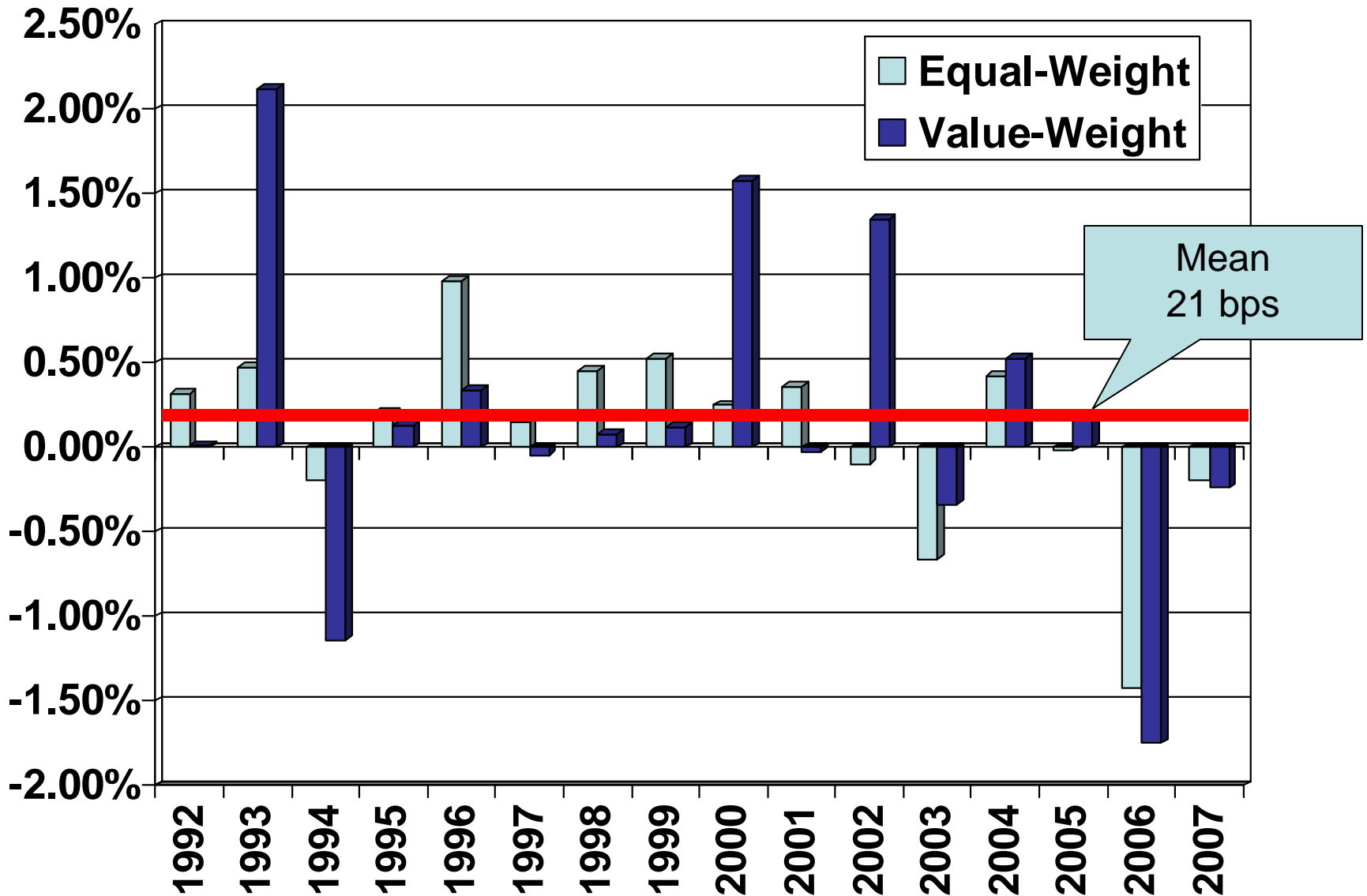
Benevolent
Enforcer

CalPERS Governance Program

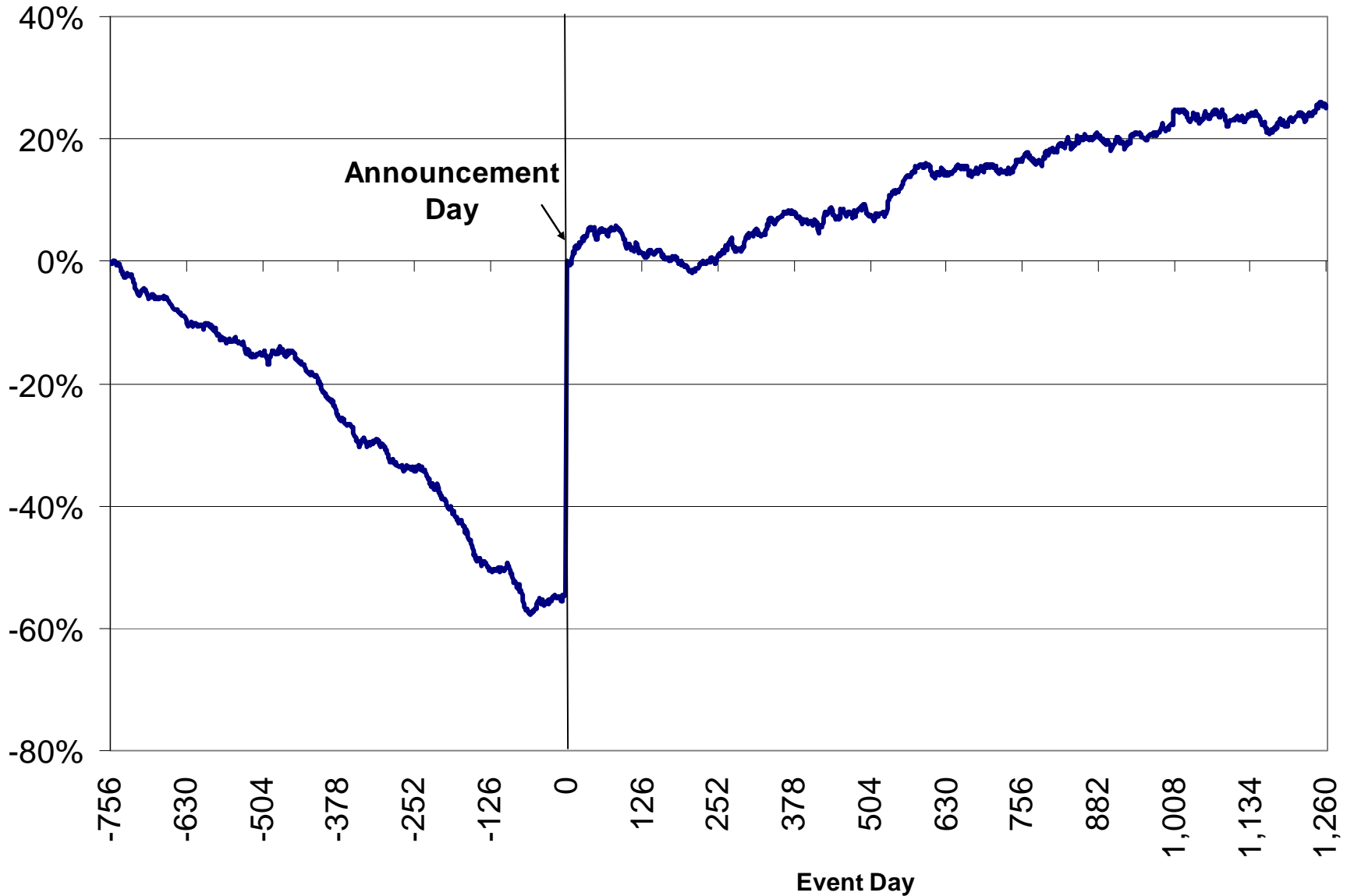


The CalPERS Focus List

Announcement Day Market-Adjusted Return



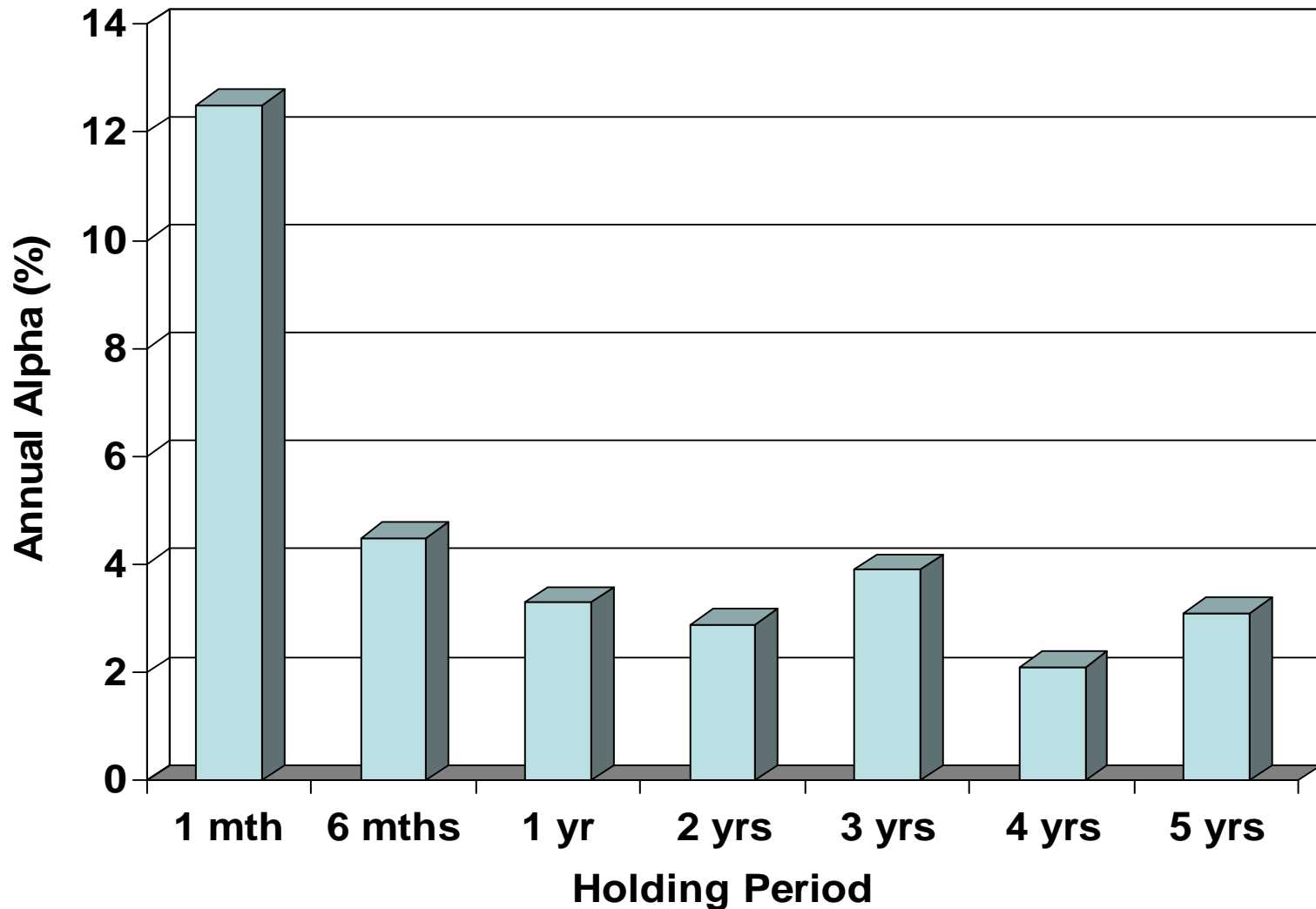
The Long-Run Evidence – A first look



The Benchmark Problem in Long-Run Return Analyses


- Several known anomalies in Returns
 - Size Premium
 - Value Premium
 - Momentum (over 6-12 months)
- Focus List Firms are Unusual
 - Value firms
 - Poor long-run returns
- Long-Run Returns are Volatile

Annualized Alpha on Focus List Portfolio over Different Holding Periods



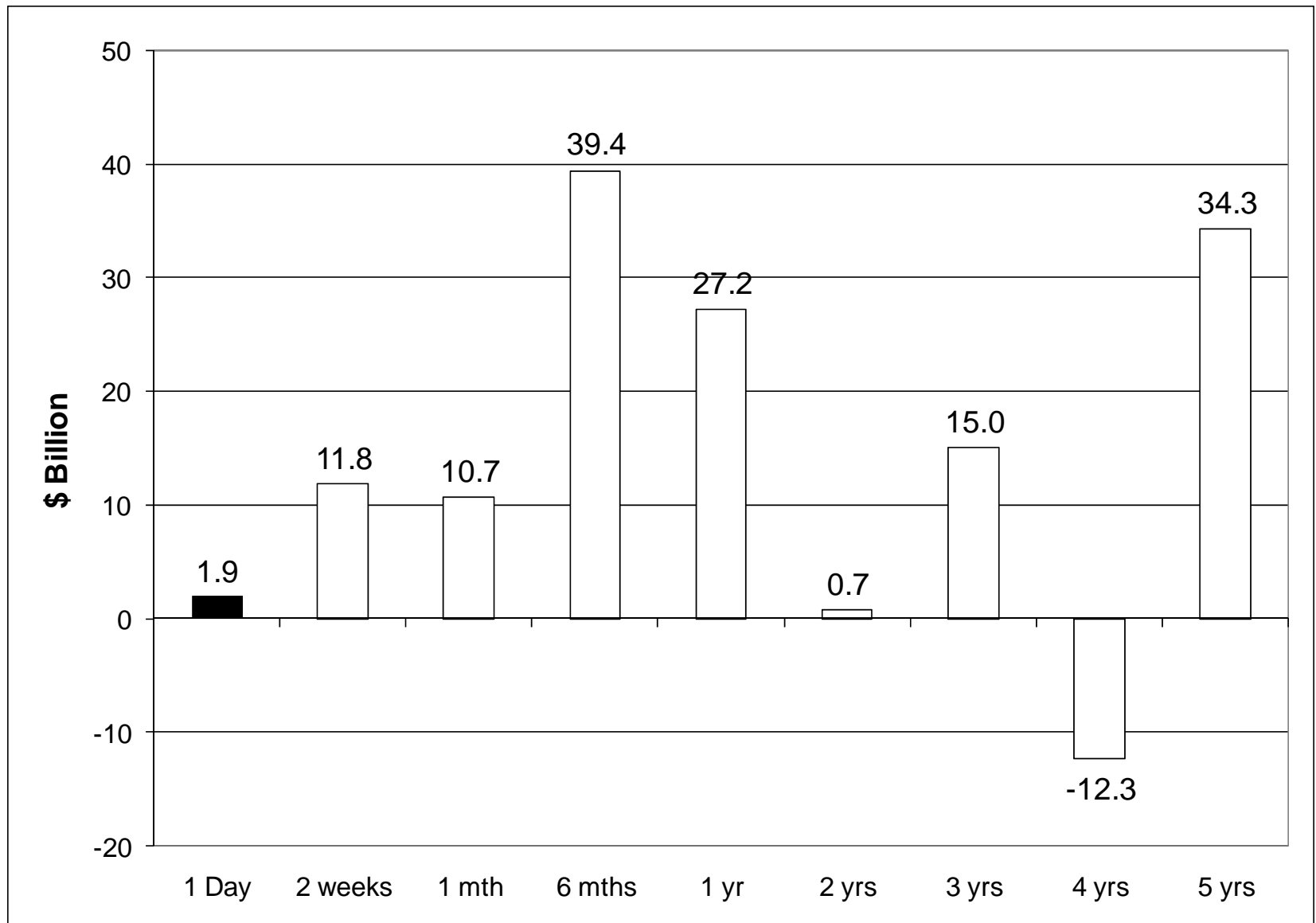
...but Returns are Volatile

Holding Period	Annualized Alpha (%)	<i>t</i> -statistic
2 weeks	42.3	1.48
1 month	12.5	0.68
6 mths	4.5	0.51
1 year	3.3	0.52
2 years	2.9	0.53
3 years	3.9	1.10
4 years	2.1	0.67
5 years	3.1	1.10



Aggregate Gains measured over different Horizons

...though statistically insignificant, they are economically large



Types of Intervention proposed by CalPERS Investment Committee

- Repeal of Poison Pills
- Declassify Board
- Appoint Majority of Independent Directors
- Eliminate Dual Class Shares
- Independence of Audit, Nominating, and Compensation Committees
 - These interventions have strong theoretical and empirical support

Beyond the Focus List

- Legislative Initiatives
 - South African Divestiture (passed)
 - Sudan Divestment (passed)
 - Iran Divestment (passed)
 - SWF-backed Private Equity Divestment (defeated)
- Board Initiatives
 - Tobacco Divestiture
 - Safeway Labor Negotiations

Social v. Shareholder Activism

- Social Activism
 - Does not affect or decreases firm value
 - Divestment constrains the opportunity set
 - A political statement about corporate practices
- Shareholder Activism
 - Designed to improve firm value
 - Positive Externalities (all shareholders benefit)

Institutions as Activists

- Social Activism can be justified if
 - Supported by investors/beneficiaries
 - Positive externalities are sufficiently large that benefits to investors (e.g., clean air) offset costs to investors (if any)
- Shareholder Activism can be justified if
 - Supported by investors/beneficiaries
 - Improves firm value

**Do Not throw the baby out
with the bath water**